

Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 IO-13 SP-02 USIA-06 AID-05 EB-07

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LAB-04 SIL-01 PA-01 PRS-01 /102 W

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FM AMEMBASSY LONDON

TO SECSTATE WASHDC 4303

INFO AMEMBASSY ANKARA

AMEMBASSY ATHENS

AMEMBASSY BERN

AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY CANBERRA

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY HELSINKI

AMEMBASSY LISBON

AMEMBASSY LUXEMBOURG

AMEMBASSY MADRID

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AMEMBASSY OTTAWA

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AMEMBASSY ROME

AMEMBASSY STOCKHOLM

AMEMBASSY THE HAGUE

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AMEMBASSY VIENNA

AMEMBASSY WELLINGTON

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C O N F I D E N T I A L SECTION 01 OF 02 LONDON 12255

E. O. 1.1L652:GDS

TAGS: PGOV, PINT, EGEN, PFOR, UK, EFIN

SUBJECT: BRITAIN IN JULY

REF: LONDON 10492

BEGIN SUMMARY: JULY IN THE UK WAS DOMINATED BY THE INTERNAL DEBATE OVER PUBLIC EXPENDITURE CUTS, BY PARLIAMENTARY MANEUVERING OVER DOCTRINAIRE SOCIALIST LEGISLATION, AND TO A LESSER DEGREE, BY BRITAIN'S PROBLEMS WITH IDI AMIN. END SUMMARY.

1. BRITISH ECONOMIC POLICYMAKERS CONTINUED IN JULY TO BALANCE THE FORCES OF ECONOMIC ORTHODOXY, REPRESENTED BY DOMESTIC INDUSTRIALISTS AND FOREIGN CREDITORS, AGAINST THE INFLUENCE OF SOCIALIST IDEOLOGY WIDELY SHARED BY THE LABOR PARTY AND THE TUC. OVER THE PAST YEAR OR SO THE ECONOMIC REALISTS HAVE BUILT UP A NARROW MARGIN IN THEIR FAVOR BUT NOT WITHOUT A FIERCE STRUGGLE. THE LATEST EXAMPLE OF THIS BATTLE IS CHANCELLOR HEALEY'S ANNOUNCEMENT OF PUBLIC SPENDING CUTS.

2. WITH THE SECOND-STAGE PAY DEAL RATIFIED BY THE TUC IN JUNE AND EVIDENCE OF AN EARLIER AND MORE ROBUST ECONOMIC RECOVERY ACCUMULATING, THE CASE FOR AN EARLY ANNOUNCEMENT OF PUBLIC EXPENDITURE CUTS BECAME COMPELLING. IN ADDITION TO PRESSURES FROM ABROAD, REVISED INTERNAL FORECASTS INDICATED THAT THE ECONOMY, LED BY EXPORTS AND INVESTMENT, WAS LIKELY TO GROW BY FIVE TO FIVE POINT FIVE PERCENT IN REAL TERMS THROUGH THE END OF 1977. GIVEN PLANNED LEVELS OF PUBLIC EXPENDITURE, IT WAS UNLIKELY THAT HEALEY'S BUDGET COMMITMENT OF FIRST PRIORITY ON AVAILABLE RESOURCES TO INVESTMENT AND EXPORTS COULD HAVE BEEN HONORED.

3. THE TWO BILLION POUND PACKAGE AT 1976 PRICES OF SPENDING REDUCTIONS AND TAX INCREASES WILL NEITHER
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FULLY SATISFY THE UK'S INTERNATIONAL CREDITORS AND BRITISH INDUSTRIALISTS, NOR WIN OVER THE POWERFUL TRADE UNION MOVEMENT AND THE LESS IMPORTANT LABOR PARTY LEFT WING. THOSE TO WHOM BRITAIN OWES MONEY WILL CONTINUE TO CRY INTO THE GOVERNMENT'S RIGHT EAR, "MORE, MORE CUTS." THE TRIBUNITES HAVE ALREADY MOANED INTO ITS LEFT, "LESS, OR BETTER YET, NONE."

4. AT THE END OF THIS PARTICULAR DAY, CALLAGHAN AND HEALEY BURIED THE RED FLAG AND SOCIALIST DOGMA A LITTLE DEEPER IN THE LABOR HOPE CHEST. THE NEW MEASURES FOLLOW A GENERALLY MONETARIST LINE BOTH IN FORECASTING A 12 PERCENT ANNUAL RATE OF GROWTH IN THE MONEY SUPPLY AND IN PROJECTING A TWO PERCENTAGE POINT INCREASE IN THE PAYROLL TAX, AN INCREASE WHOSE LONGER RUN EFFECT WILL BE TO REDUCE THE LEVEL OF REAL WAGES. THE PACKAGE WILL SHAVE THE 1977/78 PUBLIC SECTOR BORROWING REQUIREMENT BY ONE POINT FIVE BILLION POUNDS, ABOUT THE REDUCTION MOST OBSERVERS THOUGHT THE MINIMUM NECESSARY.

5. THE EXPENDITURE CUTS THEMSELVES WERE CLEARLY ALLOCATED AMONG SPENDING DEPARTMENTS IN DIRECT PROPORTION TO THE STRENGTH AND INFLUENCE OF THE INDIVIDUAL INTEREST GROUPS TO BE AFFECTED. THE LABOR-INTENSIVE DEPARTMENTS--HEALTH, EDUCATION AND WELFARE--WHICH ACCOUNT FOR 75 PERCENT OF PUBLIC SPENDING TOOK ONLY A

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FM AMEMBASSY LONDON

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INFO AMEMBASSY ANKARA

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THIRD OF THE TOTAL CUT. THE KNIFE STRUCK HARDEST AT HOUSING, OTHER FORMS OF CONSTRUCTION, AND INVESTMENT IN THE NATIONALIZED INDUSTRIES. DEFENSE TOOK EXACTLY ITS PERCENTAGE SHARE, AND THE MOD WAS RELIEVED THAT HEALEY'S SCALPEL STOPPED AT 100 MILLION POUNDS.

6. THE PAYROLL TAX INCREASE, A LAST MINUTE ADDITION, WILL CERTAINLY NARROW INDUSTRY'S PROFIT MARGINS. HOWEVER, IN A RISING ECONOMY, THE GOVERNMENT IS BETTING THAT THE NEGATIVE IMPACT OF THE TAX WILL BE PASSED THROUGH IN THE FORM OF HIGHER PRICES TO BOTH DOMESTIC AND FOREIGN CONSUMERS. THIS, TOGETHER WITH A LIBERALIZATION OF THE PRICE CODE, WOULD AT BEST LEAVE THE INCENTIVE TO INVEST MORE OR LESS INTACT. NEITHER MEASURE IS LIKELY TO ADD TO THE LEVEL OF INVESTMENT DEMAND WHICH THE GOVERNMENT IS SO ANXIOUS TO INCREASE.

7. THE PRESENT PACKAGE FALLS SQUARELY IN THE PATTERN OF CRISES WHICH HAVE BLOWN UP PERIODICALLY SINCE THE GOVERNMENT BEGAN TO TIGHTEN ITS FISCAL AND MONETARY POLICY WHILE AT THE SAME TIME RESTRAINING WAGES. AS LONG AS CALLAGHAN AND HEALEY REMAIN COMMITTED TO THIS COURSE, THEY WILL PROBABLY NOT SAIL FOR EXTENDED

PERIODS IN SILENT SEAS. THESE MEASURES SHOULD REDUCE THE PUBLIC SECTOR DEFICIT DURING THE SECOND QUARTER OF 1977. NONETHELESS, FURTHER RESTRICTIVE ACTION COULD BE REQUIRED EARLIER SHOULD THE CURRENT ACCOUNT DETERIORATE SHARPLY, OR IF STERLING AGAIN STARTS TO SLIDE. IN SUCH A SITUATION, CONVINCING THE UNIONS AND THE LABOR PARTY THAT ONCE AGAIN SACRIFICE ON THEIR PART IS THE ANSWER WOULD TAKE SOME DOING.

8. MEANWHILE, THE ECONOMY CONTINUES TO RECOVER FROM THE RECESSION WITH INDUSTRIAL PRODUCTION RISING BY OVER ONE PERCENT IN MAY FOR THE SECOND MONTH IN A ROW. THE DRAMATIC DECLINE IN INFLATION GOES ON AS THE ANNUAL
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RATE OF RETAIL PRICE INCREASE DROPPED TO 13.8 PERCENT IN JUNE. HOWEVER, THERE WILL BE LITTLE FURTHER PROGRESS ON PRICES BEFORE 1977 AS A RESULT OF THE RECENT DROP IN STERLING.

9. AS THE DEBATE OVER WHOM JIM WOULD HIT WENT FORWARD DURING MUCH OF JULY, SO DID THE GOVERNMENT'S SOCIALIST LEGISLATION IN THE COMMONS. HMG SUCCESSFULLY CURTAILED, OR AS THEY SAY HERE GUILLOTINED, DEBATE ON FIVE BILLS INCLUDING NATIONALIZATION OF THE AIRCRAFT AND SHIP-BUILDING INDUSTRIES; ELIMINATION OF PRIVATE BEDS IN HOSPITALS; AND INTRODUCTION OF COMPULSORY COMPREHENSIVE PUBLIC EDUCATION. THUS, WHILE THE INTERNATIONALEC BANKERS KEEPU WATCHFUL EYE ON THE GOVERNMENT'S ECONOMIC POLICY, THE LABOR PARTY MARCHES STEADILY FORWARD--WITH NO RESISTANCE EXCEPT THE INEFFECTUAL OPPOSITION AT WESTMINISTER--TOWARD IMPLEMENTING ITS VISION OF A MORE JUST BRITISH SOCIETY.

L0. BRITAIN'S FOREIGN PREOCCUPATIONS IN JULY CENTERED LARGELY ON UGANDA. AMIN'S REACTION TO THE ENTEBBE RAID, MRS. BLOCH'S MURDER, AND THE FIELD MARSHALL DOCTOR'S THREAT TO KENYA COMBINED TO CONVINCE HMG THAT IT WAS TIME TO CLOSE THE DIPLOMATIC CURTAIN. AFTER PURSUADING ABOUT 200 BRITISH CITIZENS TO LEAVE THE CUCKOO'S NEST, ON JULY 28 HMG BROKE RELATIONS AND LEFT A LIKE HARDCORE NUMBER TO LOOK--IF THEY CAN--AFTER THEMSELVES. WALKING AWAY FROM THE PETTY TYRANT WAS A POPULAR MOVE HERE, AND MANY ENVIED THE MUCH EARLIER US REALIZATION THAT THERE WAS NO DEALING WITH UGANDA'S MAD HATTER.

ARMSTRONG

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